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No. 99-1016

IN THE

Supreme Court of the United States

JOHN S. PEREIRA, Esq., as Chapter 11 Trustee of the Estate of Payroll Express Corporation, *et al.*,

Petitioner,

-against-

AETNA CASUALTY & SURETY COMPANY; FEDERAL INSURANCE COMPANY; CHUBB GROUP OF INSURANCE COMPANIES; ANGUS JOHN ROBERTS, an Underwriter at Lloyd's London, on behalf of himself and all those other Lloyd's Underwriters subscribing to Insurance Policy Nos. C92163400F and C92163500F,

(Action continued on inside of cover)

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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20pp

et al.; SPHERE DRAKE INSURANCE PLC; INSURANCE COMPANY OF NORTH AMERICA (UK) LIMITED "G" ACCOUNT; INSURANCE COMPANY OF NORTH AMERICA (UK) LIMITED CE MAR A/C; ZURICH RE (UK) LIMITED; NIPPON INSURANCE COMPANY OF EUROPE LIMITED; EXCESS INSURANCE CO., LTD.; OCEAN MARINE INSURANCE CO., LTD; ASSICURAZIONI GENERALI S.P.A.; THE THREADNEEDLE INSURANCE CO. LTD.; PHOENIX ASSURANCE PLC LSA ACCOUNT; COLONIA INSURANCE (UK) LIMITED "TR" ACCOUNT; THE PRUDENTIAL ASSURANCE COMPANY LIMITED TRUST ACCOUNT NO. 2; CORNHILL INSURANCE PLC "D" ACCOUNT; SIRIUS (UK) INSURANCE PLC; NORWICH NO. 1 "M" ACCOUNT; COMMERCIAL UNION ASSURANCE CO. PLC; PHOENIX ASSURANCE PLC; WURTTEMBERGISCHE FEUER VERSICHERUNG AG "AW" ACCOUNT; NORTHERN ASSURANCE COMPANY LIMITED NO. 6 ACCOUNT; YORKSHIRE INSURANCE COMPANY LIMITED; LONDON AND HULL MARITIME INSURANCE COMPANY LIMITED AXA T ACCOUNT,

Respondents.

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CORPORATE DISCLOSURE STATEMENT

In accordance with Rule 29.6 of the Rules of the Supreme Court of the United States, I certify the following: Travelers Casualty and Surety Company, successor to Aetna Casualty and Surety Company, is 100% directly owned by Travelers Property Casualty Corp., a publicly traded company. Travelers Property Casualty Corp. is approximately 84% indirectly owned by Citigroup, Inc. which is a publicly traded company.

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PRELIMINARY STATEMENT

Respondent, Travelers Casualty and Surety Company, successor to Aetna Casualty and Surety Company (hereinafter "Aetna"), respectfully submits this brief in opposition to the petition for a writ of certiorari filed by John S. Periera, Esq., as Chapter 11 trustee of the estates of Payroll Express Corporation and Payroll Express Corporation of New York (collectively referred to as "Payroll Express"), which seeks review of the Order of the United States Court of Appeals for the Second Circuit which was entered on July 29, 1999.

COUNTER-STATEMENT OF THE CASE

This section corrects the inaccuracies and omissions in the statement of the case set forth in the petition for certiorari. Respondent Aetna respectfully submits that a thorough understanding of the facts is essential to enable this Court to make a reasoned determination whether to grant the petition and review this matter.

Background

This action, which alleges breach of contract by the respondent insurers by reason of their having declined coverage for the insurance claim submitted by the Trustee, claims that Payroll Express sustained a loss as a direct result of employee dishonesty. The claimed loss is alleged to have resulted from the alleged dishonest activities of Robert Felzenberg and Barbara Felzenberg, husband and wife (collectively "the Felzenbergs"), who were Payroll Express' sole shareholders, directors and officers, and who were allegedly assisted by others. The Trustee had alleged that the Felzenbergs transferred Payroll Express funds to other entities owned by the Felzenbergs, to brokerage accounts in the names of the Felzenbergs, and to relatives of the Felzenbergs, and that the Felzenbergs made personal use of such funds. It is undisputed that the Felzenbergs dominated and controlled Payroll Express, and that no one at Payroll Express had the right to govern and direct the Felzenbergs' activities. (App. A, 81(a).)

Following his appointment by the Bankruptcy Court, the trustee, on behalf of the estate of Payroll Express, submitted a Proof of Loss to Aetna, Federal Insurance Company ("Federal"), Chubb Group of Insurance Companies ("Chubb"), and The London Excess Underwriters ("LEU") in which the trustee alleged a loss caused by employee dishonesty. The respondent insurers all denied coverage for the claimed loss on various grounds, including that the Felzenbergs constituted the alter ego of Payroll Express, and that any alleged loss was not caused by employee dishonesty. The trustee commenced this action against the respondent insurers following their declination of coverage for the claimed loss. (A short description of the litigation is set forth below.)

Aetna's Policy

Aetna had issued to Payroll Express a Comprehensive Dishonesty, Disappearance, and Destruction Policy - Form A which provided coverage to Payroll Express for loss caused by employee dishonesty. Aetna's policy does not cover losses sustained by third parties, such as customers or creditors of Payroll Express. As the Second Circuit noted, the Preamble and Insuring Agreement I of Aetna's policy provide, inter alia, as follows:

> "The Company...agrees with the Insured...to pay the Insured for:...Loss of Money, Securities and other property which the Insured shall sustain...through any fraudulent or dishonest act or acts committed by any of the Employees, acting alone or in collusion with others." (Emphasis supplied.) (App. A, 6a.)

Aetna's policy defines "Employee" as:

> any natural person (except a director or trustee of the Insured, if a corporation, who is not also an officer or employee thereof in some other capacity) while in the regular service of the Insured in the ordinary course of the Insured's business during the Policy Period and whom the Insured compensates by salary, wages or commissions and has the right to govern and direct in the performance of such service. (App. A, 6a - 7a.)

Endorsement 28 of Aetna's policy excludes Robert Felzenberg from the definition of "employee". (App. A, 7a.)

The District Court's Judgment

Aetna and the other respondent insurers moved for summary judgment before the District Court. The District Court granted summary judgment to LEU, Chubb, and Federal, and granted partial summary judgment to Aetna. In connection with Aetna, the District Court noted that the trustee had previously discontinued its claim against Aetna pertaining to losses caused by Robert Felzenberg (App. D, 80a.) In granting partial summary judgment to Aetna, the District Court determined that Barbara Felzenberg was not an "employee", as that term is defined in Aetna's policy, and that she constituted the contractual alter ego of Payroll Express. (App. D, 88a.) The District Court also determined that there was no evidence in the record to support the trustee's allegation that the alleged loss was caused by the dishonesty of Alicia and Emily Felzenberg, the Felzenbergs' children. (App. D, 92a.)

The remaining claims which had not been dismissed by the District Court, and which pertained to the alleged dishonesty of George Gillmore, Robert Gussow, Rose Felzenberg and Howard Messer, were later discontinued with prejudice pursuant to a stipulation entered into by the Trustee and Aetna. (App. A, 15a - 16a.)

The Second Circuit's Judgment Affirming the Judgment of the District Court

The United States Court of Appeals for the Second Circuit affirmed the judgment of the District Court. In affirming the judgment, the Second Circuit agreed with the District Court's holding that the Felzenbergs were the contractual alter egos, and not employees, of Payroll Express. (App. A, 14a - 15a.) The Second Circuit also agreed with the District Court that there was no evidence to support the claim that any losses sustained by Payroll Express were caused by the dishonesty of Alicia and Emily Felzenberg. (App. A, 15a.)

The Trustee's Petition

The trustee's petition does not contest that portion of the Second Circuit's judgment which affirmed the granting of summary judgment to Aetna, Chubb and Federal. Although the trustee initially requests a writ of certiorari "to review the judgment of the United States Court of Appeals for the Second Circuit...in this case" (Petition, p.1), he subsequently narrows the scope of his petition when he states that he seeks this Court's review of only "the Court of Appeals' affirmance of the District Court's decision granting summary judgment to the LEU." (Petition, p.6.) Other than briefly mentioning Aetna in describing the background of this matter, the Trustee makes no mention whatsoever of Aetna in his arguments, and the arguments appear to be directed solely against LEU. (Petition, pp.6-16.)

Further, none of the trustee's arguments can logically be directed against Aetna. In argument I of his petition (pp.6-13), the trustee argues that the imputing of the dishonesty of Robert Felzenberg to the trustee and creditors is in conflict with decisions of other United States Courts of Appeals. As Aetna's policy only covers the insured for loss sustained by it as a result of employee dishonesty (App. A, 6a), as Endorsement 28 of Aetna's policy specifically excluded

Robert Felzenberg from the policy's definition of "employee" (App. A, 7a), and as the trustee specifically discontinued all claims against Aetna which pertained to Robert Felzenberg's dishonesty (App. D, 80a), the arguments asserted by the trustee on pages 6-13 of his petition simply cannot apply to Aetna.

In addition, the trustee's arguments set forth in argument II of his petition (pp. 13-16) pertain to Robert Felzenberg's misrepresentations in his application, on behalf of Payroll Express, for insurance coverage from LEU. Accordingly, such arguments can only apply to LEU, and cannot apply to Aetna.

As the trustee has presented no argument which even remotely pertains to Aetna, it is apparent that the petition does not contest the granting of summary judgment to Aetna. Therefore, as set forth in Point I below, the granting of summary judgment to Aetna is not before this Court.

The trustee's petition also contains inaccuracies. In his petition, the trustee claims that Payroll Express' customers demanded protection under the fidelity policies which had been issued to Payroll Express, and that Payroll Express purchased fidelity policies from the respondents in order to protect itself and its customers from losses caused by employee dishonesty. Yet, whether customers in fact requested such protection from Payroll Express or not is irrelevant to the trustee's action against Aetna, since, as stated above, Aetna's fidelity insurance policy does not provide coverage to third parties, but only to the insured, Payroll Express (App A, 6a).

In arguing that he seeks to recover insurance proceeds on behalf of the creditors of Payroll Express (Petition, p. 17), the trustee contradicts his own allegation, set forth in paragraphs "1", "2", "5" and "12" of the Complaint, that he represents the Estate of Payroll Express. Consistent with that allegation, the trustee previously admitted, in response to Aetna's Local Civil Rule 56.1 statement of uncontested facts, that he stands in the shoes of Payroll Express,

that he has no greater rights than Payroll Express, and that he is subject to the same defenses that Payroll Express would have been subject to had Payroll Express submitted the insurance claims at issue in this action.

POINT I

The Second Circuit's affirmance of the District Court's granting of partial summary judgment to Aetna is not before this court

The only issues presented for review by this Court in the petition for a writ of certiorari pertain to the District Court's granting of summary judgment in favor of LEU and the Second Circuit's affirmance of same. The petition does not address, and therefore, does not contest, the granting of summary judgment to Chubb and Federal, or the granting of partial summary judgment to Aetna. (As stated above on pages 4-5, the arguments presented by the petitioner cannot logically apply to Aetna.) Accordingly, those issues addressed by the Second Circuit concerning the trustee's claims against Aetna, Federal and Chubb are not before this Court.

In accordance with Rule 14.1(a) of the Rules of this Court, "only the questions set out in the petition, or fairly included therein, will be considered by the Court." This Court has repeatedly declined to address issues not raised in the petition for certiorari or in a cross-petition for certiorari. See, Izumi Seimitsu Kogyo Kabushiki Kaisha v. U.S. Philips Corporation, 510 U.S. 27, 30-31 (1994) (declining to address issue "neither presented as a question in the petition for certiorari nor fairly included therein"); City of Oklahoma City v. Tuttle, 471 U.S. 808, 814 n.2 (1985) (Court's holding confined to question actually presented in petition for certiorari). And there are no exceptional circumstances at bar in this routine contract case which would justify a departure from this Court's stated policy of declining to

address issues not set forth in the petition for certiorari. Yee v. City of Escondido, California, 503 U.S. 519, 535 (1992) (Rule 14.1(a), although prudential in nature, is only to be disregarded in the most exceptional case, "where reasons of urgency or economy suggest the need to address the unpresented question"); Stone v. Powell, 428 U.S. 465, 482 n.15 (1976) ("only in the most exceptional cases will we consider issues not raised in the petition").

Accordingly, we respectfully submit that the Second Circuit's judgment affirming the District Court's granting of partial summary judgment to Aetna should not be reviewed by this Court.

POINT II

Petitioner has failed to establish any conflict between different United States Courts of Appeals on an important matter

This Court should also deny the trustee's petition because the trustee has failed to set forth any compelling reason which merits this Court's review of the Second Circuit's judgment.

This action involves nothing more than a simple contract dispute between various insurers and an insured (or in this case, a trustee who stands in the shoes of the insured.) Therefore, this is not the type of case which compels review by this Court.

That the trustee claims to look out for the interests of the third-party creditors of Payroll Express, rather than the Estate of Payroll Express, does not change the contractual nature of this dispute. Nor are the interests of the third party creditors even relevant, as it is well-recognized that fidelity policies of insurance, such as Aetna's policy, provide coverage only for losses sustained by insureds thereunder, and not for losses sustained by third parties. 175 East

74th Corp. v. Hartford Acc. & Indem. Co., 51 N.Y.2d 585, 416 N.E.2d 584, 435 N.Y.S.2d 584 (1980); Aetna Cas. & Surety Co. v. Kidder, Peabody & Co. Inc., 246 A.D.2d 202, 209, 212, 676 N.Y.S.2d 559, 563, 565 (1st Dept. 1998), lv. to appeal denied, 93 N.Y.2d 805, 689 N.Y.S.2d 429 (1999). And New Jersey law precludes recovery by Payroll Express' creditors under Aetna's policy. Dawson v. National Union Fire Ins. Co. of Pittsburgh, PA., 285 N.J.Super. 137, 141-43, 666 A.2d 604, 606-07 (App.Div. 1995), cert. denied, 143 N.J. 517, 673 A.2d 276 (1996); Liberty Mutual Fire Ins. Co. v. Kahlaid, Inc., 199 N.J.Super. 494, 497-98, 489 A.2d 1231, 1232 (App.Div. 1985), cert. denied, 101 N.J. 300, 501 A.2d 958 (1986).

Further, the fact that the trustee claims to speak for the creditors does not change the fact that the trustee, as a matter of law, is subject to the same policy defenses as the insured would be subject to had it submitted the insurance claims at issue, Bank of Marin v. England, 385 U.S. 99, 101 (1966), (App. A, 28a), since a trustee obtains no greater rights in connection with the submission of an insurance claim (or the commencement of an action) than the insured debtor would have had had it submitted the claim (or commenced the action). Zartman Trustee v. First National Bank, 216 U.S. 134, 138 (1910).

Further, the trustee has failed to comply with Rule 10 of this Court in that he has not set forth any compelling reason why this Court should grant his petition for a writ of certiorari. Despite his claim to the contrary, the trustee has not established the existence of a conflict between different United States Courts of Appeals on the same important matter, nor has he shown that the Second Circuit decided an important Federal question in a way which conflicts with a decision by the state court of last resort. (In fact, there is no federal question involved in this action, only the application of state law to this routine contract dispute.)

Petitioner mischaracterizes the decision by the Second Circuit and decisions from other Courts of Appeals in an effort to manufacture a purported conflict between the Circuits. In doing so, the trustee fails to point out that (a) the facts in this case are different from the facts in those cases relied upon by the trustee; (b) this action was determined under New Jersey law, which, as the Second Circuit noted, has not adopted the legal theories espoused by the trustee, while certain of the cases relied upon by the trustee were decided under the laws of other states which mandated contrary rulings; and (c) the question presented by the trustee-whether a bankruptcy trustee and creditors receive less protection from the United States Court of Appeals for the Second Circuit than from other United States Courts of Appeals-is phrased in a manner which is inconsistent with the holdings relied upon by the trustee.

Petitioner argues that the United States Courts of Appeals for the Fifth and Tenth Circuits and the Washington Court of Appeals refused to impute the wrongdoing of respective agents to their principals, whereas the Second Circuit imputed the wrongdoing of Robert Felzenberg to Payroll Express in connection with his misrepresentations in applying for insurance from LEU. Yet, the cases cited by the trustee, Adair State Bank v. American Cas. Co. of Reading, Pa., 949 F.2d 1067 (10th Cir. 1991); Federal Deposit Insurance Corp. v. Aetna Cas. & Sur. Co., 426 F.2d 729 (5th Cir. 1970); and Puget Sound Nat'l Bank v. St. Paul Fire & Marine Ins. Co., 32 Wash. App. 32, 645 P.2d 1122 (Wash. App. Div. 1982), review denied, 97 Wash.2d 1036 (Wash. 1982), are plainly distinguishable from the case at bar.

The cases cited by the trustee all involved boards of directors of banks which actively oversaw the activities of the dishonest officers, and from whom the dishonest officers had hidden their dishonest conduct. In the case at bar, however, the trustee has admitted, and the District Court noted, that no one at Payroll Express had the right to oversee the activities of the dishonest individual, Robert Felzenberg. (App. D, 81a.) (The District Court noted that both

Robert and Barbara Felzenberg, who were Payroll Express' sole shareholders, officers and directors, dominated and controlled Payroll Express, and that no one at Payroll Express had the right to govern and direct either of their activities. (App. D, 81a.)

Further, in Adair State Bank, the Tenth Circuit applied Oklahoma law as an aid in interpreting whether coverage existed under certain fidelity bonds. As the Court stated: "Because the bond in question is required by statute, we review the bond in light of the statute and read its terms into the bond." 949 F.2d 1067, 1072. One provision of the Oklahoma statute required that any bank officer or employee who fraudulently paid out any bank funds upon a check where there was no deposit with the bank of a sum equal to that check would be personally liable to the bank for said sum, and his liability would be covered by the fidelity bond. 949 F.2d 1067, 1073. As the Court found that certain bank officers had actively hidden their dishonest acts from the bank's board of directors, and because the statute required that the officers' dishonesty be covered under the fidelity bonds, the dishonest acts of the officers were not imputed to the insured bank so as to defeat recovery under the bonds. In reaching this determination, the court apparently applied the "adverse domination" theory, which is referred to by the trustee in his petition.

In the case at bar, the Second Circuit applied New Jersey law (which the trustee had requested that the District Court apply) in reaching its determination. New Jersey, however, has not adopted the adverse domination theory. Levitt v. Riddell Sports, Inc. (In re MacGregor Sporting Goods, Inc.), 199 B.R. 502, 515 (Bankr. D. N.J. 1995), (App. A, 20a). Nevertheless, even assuming, arguendo, New Jersey had adopted the "adverse domination" theory, that theory would still not apply to the case at bar where the trustee has admitted, and the Second Circuit has noted, that no one at Payroll Express governed or directed Robert Felzenberg's activities at Payroll Express, and that Robert and his wife, his alleged co-conspirator, were the 100% shareholders of Payroll Express.

In Puget Sound Nat'l Bank, relied upon by the trustee, the Washington Court of Appeals, after stating the general rule that "a principal is chargeable with notice of facts which are within the knowledge of his agent, acquired within the scope of the agent's authority", 32 Wash. App. 32, 40, pointed out the exception to the rule, that knowledge will not be imputed to the principal where it is to the advantage of the agent to conceal knowledge which he has acquired from his principal. 32 Wash. App. 32, 40. However, as the Court also noted, the exception to the rule is qualified by another rule that "if the agent is the sole representative of the principal, or the only person or means by which the principal acts, then the knowledge of the agent will be imputed to the principal, and the general rule applies... ." 32 Wash. App. 32, 40.

In Puget Sound Nat'l Bank, the dishonest employee, one Dreitzler, was held not to be the sole representative of the insured bank, and his dishonesty was therefore not imputed to the bank. In the case at bar, however, it is undisputed that Robert Felzenberg was the sole representative of Payroll Express insofar as applying for and obtaining insurance coverage for Payroll Express, and that, as stated above, no one at Payroll Express had the right to govern and direct Mr. Felzenberg's activities. (App. D, 81a.)

The trustee further erroneously argues that the Second Circuit's decision in the case at bar is in conflict with a decision of the Eleventh Circuit in American Mfg. Mut. Ins. Co. v. Tison Hog Market, Inc., 182 F.3d 1284 (11th Cir. 1999). This argument is also erroneous.

Tison Hog involved the interpretation of a surety bond in which the surety had guaranteed the principal of payment to the principal's creditors. As the trustee states, on page 10 of his petition, in quoting from the Eleventh Circuit's discussion in Tison Hog concerning the nature of suretyship contracts: "A creditor does business with a principal in reliance upon the existence of a bond." (Emphasis supplied by trustee.) 182 F.3d at 1288. The trustee then argues that

the Eleventh Circuit and two courts within the Third Circuit have determined that misrepresentations by dishonest agents should not be imputed to principals or principals' creditors. Yet, none of the arguments asserted by the trustee have any applicability to the case at bar.

The case at bar involves the interpretation of fidelity policies of insurance, and not surety contracts as were involved in the Tison Hog case. While a suretyship contract is a tri-part agreement among the surety, the principal and the obligee, in which payment to the obligee is guaranteed in the event of a default by the principal, a fidelity policy is a first-party policy of insurance between the insurer and the insured in which the insurer agrees to pay the insured, and not third-parties, for certain covered losses sustained by the insured. 175 East 74th Corp. v. Hartford Acc. & Indem. Co., 51 N.Y.2d 585, 416 N.E.2d 584, 435 N.Y.S.2d 584 (1980); Aetna Cas. & Surety Co. v. Kidder, Peabody & Co. Inc., 246 A.D.2d 202, 209, 212, 676 N.Y.S.2d 559, 563, 565 (1st Dept. 1998), lv. to appeal denied, 93 N.Y.2d 805, 689 N.Y.S.2d 429 (1999). And New Jersey law, under which the present action was determined, precludes recovery by Payroll Express' creditors. Dawson v. National Union Fire Ins. Co. of Pittsburgh, PA., 285 N.J.Super. 137, 141-43, 666 A.2d 604, 606-07 (App.Div. 1995), cert. denied, 143 N.J. 517, 673 A.2d 276 (1996); Liberty Mutual Fire Ins. Co. v. Kahlaid, Inc., 199 N.J.Super. 494, 497-98, 489 A.2d 1231, 1232 (App.Div. 1985), cert. denied, 101 N.J. 300, 501 A.2d 958 (1986).

Aetna's fidelity policy provides indemnity coverage for only certain direct losses sustained directly by the insured, Payroll Express, by reason of employee dishonesty as defined by the policy, and not for those losses allegedly sustained by its customers/creditors.

On page 12 of his petition, the trustee erroneously argues that in applying Tison Hog to the case at bar, the creditors in this action would not have done business with Payroll Express but for the

carriers' issuance of commercial crime coverage for losses caused by the dishonesty of Payroll Express' agents. This argument, however, simply ignores the distinct difference between the terms of the surety contract in Tison Hog and the terms of the fidelity policies issued to Payroll Express in the case at bar. Accordingly, the trustee's reliance upon Tison Hog is misplaced.

Based on the foregoing, the trustee has failed to establish any conflict among the Circuit Courts over an important matter of law.

CONCLUSION

As stated above, the trustee has set forth no arguments specifically directed to Aetna, and, therefore, does not contest that portion of the Second Circuit's judgment which affirms the granting of summary judgment to Aetna. As the trustee has failed to set forth any arguments with respect to the granting of summary judgment to Aetna, Chubb and Federal, the granting of summary judgment to those respondents are not before this Court, and cannot later be raised by the trustee.

Further, the trustee has failed to come forth with any compelling reason why this Court should grant the trustee's petition, and the argument that this Court needs to urgently review a disagreement between various Courts of Appeals concerning an important matter is simply unfounded.

Accordingly, respondent Aetna respectfully requests that the trustee's petition for a writ of certiorari be denied.

Respectfully submitted,

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